Approved February 1, 1984
Date

MINUTES OF THE SENATE COMMITTEE ON COMMERCIAL AND FINANCIAL INSTITUTIONS.

The meeting was called to order by Sen. Neil H. Arasmith at
Chairperson

9:00 a.m./~~p.m.~~ on January 31, 1984 in room 529-S of the Capitol.

All members were present except:

Sen. Hess - Excused

Committee staff present:

Bill Wolff, Legislative Research
Bruce Kinzie, Revisor of Statutes

Conferees appearing before the committee:

Jim Maag, Kansas Bankers Association
Harold Stones, Kansas Bankers Association
Jim Holt, Fourth National Bank, Wichita
Duane Fager, Kansas Bankers Assocition, Commerce Bank of Topeka
Jim Turner, The Kansas Association of Savings Institutions

The minutes of January 25 were approved.

The chairman called on Jim Maag, Kansas Bankers Association, to give his testimony on SB 523. (See Attachment I.) Mr. Maag began by introducing others who had come to speak or answer questions on the bill--Duane Fager, Jim Holt, Rich McDonald, and Richard Schopf.

Mr. Maag called on Harold Stones, Kansas Bankers Association, to give further testimony on SB 523 insofar as background information on remote service units. Mr. Stones noted that the first electronic funds transfer service (EFTS) bill was passed ten years ago and that it has proved to be an excellent law. He added that Kansas was a pioneer in this type of legislation. He said the law was passed because it was noncontroversial in the banking industry and still is, the reason being that it does not give any bank any new powers but rather gives banks a new set of convenient tools with which to operate. It offers a further advantage to small communities in that it allows that community to keep its customer if he moves to an urban area. Mr. Stones said that a final advantage of the bill is that as deregulation is coming to an end, the future of small community banks is assured because they can continue to give services and offer additional services that other banks offer to their customers. Mr. Stones concluded by saying that the Kansas legislature deserves credit for allowing Kansas to be a leader in this area. The chairman then requested that Mr. Stones submit his testimony in writing for the committee.

Mr. Maag then introduced Jim Holt, Fourth National Bank of Wichita, to give testimony in support of SB 523 and the amendment offered. Mr. Holt presented a history of automatic teller machines (ATM), the current status, and the future of remote service units giving statistical data as to the increased use of ATM. He said that twenty four hour banking is no longer a competitive service but rather an expected service of banks and that this service has become nationwide.

Sen. Harder asked if there is a charge for the card used for the ATM service. Mr. Holt answered that there is not a charge for the card but that there is a charge for the transaction.

Sen. Karr had questions as to if the ATM service was a money maker, and Mr. Holt replied that the charge for the service is forty to fifty cents per transaction and that several banks share in the fee as well as the use of the ATM. Sen. Karr said that the cost seems higher than for other transactions. Mr. Stones explained that it is up to the individual bank what they charge the customer for the transaction.

Sen. Gannon questioned the need for the bill if the use of this service is already nationwide as stated by Mr. Holt. In answer to this, the chairman called attention to Mr. Maag's written testimony in which it is stated that the bill is needed,

according to the Attorney General's opinion, to clarify its intent to allow ATM services. Mr. Holt agreed with the chairman that the only differnce between this bill and the authority given to savings and loans several years ago would be that it could be in any state whether reciprical or not.

Sen. Feleciano asked Mr. Holt the rationale of charging a forty to fifty cent fee for these cards because it has been said that technology is supposed to reduce the work load and, therefore, reduce charges. Mr. Holt answered that technology is expensive to develop and that there is a possibility that eventually there will be a decrease in charges as the number of cardholders increase.

Sen. Karr asked if the bill was intended for the opening of multi-national banking services, and Mr. Holt said that it was so intended.

The chairman asked if other states have similar restrictions as Kansas does now. Mr. Holt answered that he did not have facts to answer this question.

Sen. Gordon inquired if other facilities would have access to a customer's private finances through these remote service units. Mr. Holt responded that this possibility exists but that there are ways to implement security procedures.

The chairman questioned Mr. Holt as to the longevity of the remote service units. Mr. Holt answered that the units are set up on a service agreement with the vendor. Also, new machines with more features will be replacing the older machines.

Mr. Maag asked the committee to hear Duane Fager of Commerce Bank in Topeka and Chairman of the Kansas Bankers Association's EFT Committee who wished to comment on the questions posed to Mr. Holt. He began by stating that his is a state bank, and state banks are in need of this bill unlike the federal banks who are subject to the Comptroller of Currency. He added that the pricing of a transaction varies from bank to bank. His bank's charges are based on balances and checks written, and it encourages the use of cards for efficiency purposes. He noted that the ATM are not inexpensive and that one can expect only eight to nine years of service from a machine.

The chairman called on Jim Turner, The Kansas Association of Savings Institutions, to give his testimony on SB 590, a companion measure to SB 523 for savings and loans. (See Attachment II.) In regard to the previous discussion concerning the charge for ATM transactions, Mr. Turner commented that the charge is for the system and is not necessarily passed on to the customer; in fact, in most cases, it is not passed on to the customer. Mr. Turner said that he supports the passage of both SB 523 and SB 590. He concluded by saying that very soon one will be able to use plastic cards in such places as Sears and K-Mart and that he would like saving and loans to be able to offer this service too.

The chairman announced that SB 523 and SB 590 are taken under advisement due to lack of time to make any motions.

The meeting was adjourned.

NATE COMMITTEE

ON

COMMERCIAL AND FINANCIAL INSTITUTIONS

OBSERVERS
(Please print)

DATE	NAME	ADDRESS	REPRESENTING
1/31/84	John Spurgeon	Lawrence	Budget
"	Tom Wilder	Topeka	KSLL
	John Peterson	Topeka	KAFC
"	Jewel Wright	"	KCUL
"	Sue Ellen Doyle	Wichita	KCUA
	[illegible]	Topeka	KCUL
"	[illegible]	"	KBA
	Duane Fager	"	KBA
	Jim Holt	Wichita	4th Nat'l Bank
	Rick McDonald	Wichita	Fourth Nat'l
	Richard Schopf	Wichita	KETS, Inc.

SENATE COMMITTEE ON COMMERCIAL AND FINANCIAL INSTITUTIONS

TESTIMONY ON SB 523

BY

KANSAS BANKERS ASSOCIATION

JANUARY 31, 1984

Attachment I

The KANSAS BANKERS ASSOCIATION
A Full Service Banking Association

January 31, 1984

TO: Senate Committee on Commercial and Financial Institutions

RE: SB 523--Interstate use of Remote Service Units

Mr. Chairman and members of the of committee:

We appear before you today in support of SB 523. Since the early 1970's the Kansas legislature has take a very positive approach to the issue of allowing financial institutions in Kansas to establish Remote Service Units. By granting banks the authority to determine the location of their RSUs on an intrastate basis, it has enabled Kansas banks to provide a much needed service to the citizens of our very mobile society.

Committee members will recall that in 1975 the Kansas legislature authorized state or national banks, having their principal offices in this state, to individually or jointly provide transactions by means of remote service units (RSUs) located anywhere in the state. There is by statute no limitation as to the number of such units which may be provided by a Kansas bank and utilized to engage in banking transactions. There are limitations expressed, however, that the banks engaging in banking transaction by means of such units must have their principal offices located within Kansas and the RSUs must be located within the state.

With the rapid advances in electronic funds transfer (EFT) technology it is now possible for bank customers to not only access remote service units within the state of Kansas, but to also access such units in other states throughout the country by means of recently established regional and national networks. However, the Attorney General in Opinion 83-100 issued on June 29, 1983 at the request of the State Bank Commissioner, stated there is currently no statutory authority for Kansas banks to enter into contracts with state or national banks located in other states for the use of remote service units in those states.

In 1982, the Kansas legislature did pass legislation allowing savings and loan associations to contract with other such associations for their operation of remote service units in Kansas or in other states. As the Attorney General pointed out in his opinion "it is clear that the legislature, when it desires to do so, is capable of opening the door for out-of-state financial institutions to operate remote service units in Kansas." That same law, of course, authorizes Kansas S&Ls to contract for the use of RSUs in recipricating states.

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The provisions of SB 523 speak to the granting of authority for Kansas banks to engage in banking transactions by means of remote service units wherever located. Quite obviously the decision as to whether a Kansas bank can access and use RSUs in other states is a determination which can be made only by the state legislatures of those respective states. Thus, the impact of this legislation is simply to grant Kansas banks the authority to enter into contractual agreements for the use of RSUs on an interstate basis if so allows by the law in those states.

We would emphasize to the committee that from the time RSU legislation was first considered in the state of Kansas it has not been considered a "structure" issue with members of our association. All Kansas banks, regardless of what their philosophy might be on other structure matters involving the Kansas banking system, believe that the establishment of a flexible remote service unit system on both an intrastate and interstate basis is in the best interests of the customers of Kansas banks. One major reason for the complete lack of controversy through the years of EFTS development, was the language, established in the 1975 law, which required any bank, placing an RSU off premise, to share that electronic machine with any other bank willing to share in the costs. That same requirement will continue in the statute. The ability of a bank to provide service to its customers in today's highly mobile society and competitive market place is extremely important.

Because of the rapid advances in technology, we would hope that as the committee considers this bill that they keep in mind the need for flexibility in RSU legislation and, thus, allow financial institutions to adapt quickly to the rapid technological changes without encountering statutory delays.

Again, we commend the legislature their enlightened viewpoint on RSU legislation and we sincerely hope that the committee will give favorable consideration SB 523.

James S. Maag
Director of Research

STATE OF KANSAS

OFFICE OF THE ATTORNEY GENERAL

2ND FLOOR, KANSAS JUDICIAL CENTER, TOPEKA 66612

ROBERT T. STEPHAN
ATTORNEY GENERAL

June 29, 1983

MAIN PHONE: (913) 296-2215
CONSUMER PROTECTION: 296-3751
ANTITRUST 296-5299

ATTORNEY GENERAL OPINION NO. 83- 100

John O'Leary, Jr.
State Bank Commissioner
700 Jackson, Suite 300
Topeka, Kansas 66603

Re: Banks and Banking -- Banking Code; Powers -- Branch Banking Prohibition; Interstate Contract for Use of Remote Service Units

Synopsis: K.S.A. 9-1111(f) provides that any state bank or national banking association located in Kansas may operate remote service units, by means of which banking transactions may take place. Such facilities may be located anywhere within the state, including at the place of business specified in the bank's certificate of authority. Any state bank or national banking association located in Kansas may enter into agreements with any other banks having their principal place of business in this state for the joint operation of such facilities. In the absence of statutory authority, however, Kansas banks may not enter into such contracts with state or national banks located in other states. Cited herein: K.S.A. 9-1111, K.S.A. 1982 Supp. 17-5565, 12 U.S.C. §36.

* * *

Dear Commissioner O'Leary:

As Bank Commissioner for the State of Kansas, you have requested the opinion of this office on a matter concerning the operation of remote service units, as that term is used in K.S.A. 9-1111. This statute, the so-called branch banking statute, allows a state or national bank to operate remote service units in this state, and does not consider such units to be branches, the operation of which is prohibited.

Your inquiry stems from a situation involving a Kansas state bank and a national bank located in Missouri, and raises the question of whether two banks so situated may jointly operate remote service units.

Prior to examining the legal issues involved, a brief summary of the facts set out in your letter and the accompanying materials would be helpful. United Missouri Bank of Kansas City, N.A., (UMB) is a national banking association organized and doing business in Kansas City, Missouri. Almost 100% of its stock is owned by United Missouri Bancshares, a Missouri bank holding company that also owns a controlling interest in 19 other Missouri banking corporations. UMB has obtained the right to use the name "Ultra" in connection with automatic teller machines and the encoded plastic cards used to activate such machines. It has entered into contracts with 7 other banks in the Kansas City metropolitan area whereby the banks, referred to as correspondent banks, may use the Ultra name in connection with automatic teller machines located on their premises. While 5 of the 7 banks are controlled by United Missouri Bancshares, one of the others is a Kansas bank located in Overland Park, Kansas. The contracts have resulted in a network of automatic teller machines operating at 15 locations, each of which is tied in to the central computer at UMB. Each correspondent bank either owns or leases the machines located on its premises.

As part of the contract, the correspondent bank permits customers of UMB, as well as all other banks who have signed contracts with UMB, to have access to its Ultra machine. The Ultra card activates the machine, and allows the customer to perform six different transactions: withdrawal of cash from a checking account; transfer of money from a checking account to a savings account; transfer of money from a savings account to a checking account; withdrawal of cash from a MasterCard line of credit; transfer of money from a MasterCard line of credit to a checking account; and inquiries concerning account balances. Therefore, a UMB customer with an Ultra card may enter into any of the above transactions at any of the 15 locations, including those in Kansas. Likewise, a customer of the Overland Park bank may use both the Kansas and Missouri machines for his or her banking transactions. Each transaction is reflected in the computer record at UMB, and the changed balance in a customer's account will subsequently show in all 15 of the outlets.

The legal question presented by this fact situation concerns the authority of the Overland Park bank to enter into such an agreement with a bank in another state. The fact that UMB is a national association is not determintive, for in questions regarding branch banking, state law controls when, where,

and how a national bank may branch, if indeed it may do so at all. State ex rel. Edwards v. Heimann, 633 F.2d 886 (9th Cir. 1980), applying 12 U.S.C. §36. Accordingly, reference must be had to the applicable provision of the Kansas Banking Code, specifically, K.S.A. 9-1111. We further note that, in the interest of maintaining competitive equality between state and national banks [First National Bank v. Walker Bank & Trust Co., 385 U.S. 252, 17 L.Ed.2d 343 (1966)], remote service units have been held by federal courts to constitute branch banks. State of Colorado v. First National Bank of Fort Collins, 540 F.2d 497 (10th Cir. 1976), and cases cited at 499.

Initially, K.S.A. 9-1111 contains a general prohibition against establishment of any branch bank, office, agency or place of business by a bank doing business in this state. Three exceptions are then made to this general prohibition, e.g. for attached auxiliary teller facilities, detached auxiliary banking service facilities, and remote service units. Remote service units are defined at K.S.A. 9-1111(h) to mean the following:

> "an electronic information processing device, including associated equipment, structures and systems, through or by means of which information relating to financial services rendered to the public is stored and transmitted, whether instantaneously or otherwise, to a bank and which, for activation and account access, is dependent upon the use of a machine-readable instrument in the possession and control of the holder of an account with a bank. The term shall include 'online' computer terminals and 'offline' automated cash dispensing machines and automated teller machines, but shall not include computer terminals or automated teller machines . . ."

From the above, there can be no question that the automatic teller machines described above fall within the class of remote service units for purposes of Kansas law.

Authorization for operation of remote service units is contained in subsection (f) of the statute, which states:

> "any state bank or national banking association having its principal office and main banking house in this state, individually or jointly with one or more state banks or national banking associations having their principal offices and main banking houses in this state, may provide, and engage in banking transactions by means of remote service units located anywhere within the state of

> Kansas, which remote service units shall not be considered to be branch banks, or branch offices, agencies or places of business, or detached auxiliary services facilities authorized herein. Any banking transaction effected by use of a remote service unit shall be deemed to be transacted at a bank and not at a remote service unit;" (Emphasis added.)

It is important to note that while the subsection allows the joint operation of remote service units by two or more state or national banks, the grant of authority is explicitly limited to those banks "having their principal offices and main banking houses in this state." While subsection (g) permits the type of unit sharing which was described above, i.e., a bank with a remote service unit must allow customers of another bank to use the facility, subsection (f) controls the type of agreements which can be made initially for the joint operation of such facilities, and is silent as to the type of agreement entered into in the above scenario.

Also relevant is the recent action of the 1982 Kansas Legislature in amending K.S.A. 17-5565. L. 1982, ch. 106. As amended, this statute now allows savings and loan associations to contract with other such associations for the operation of remote service units in Kansas or in other states. There is no requirement that all of the associations have their principal place of business in this state, for indeed the statute expressly permits "foreign" savings and loan associations to operate such units in Kansas, provided that reciprocal privileges are afforded to Kansas associations in the other state. Accordingly, it is clear that the legislature, when it desires to do so, is capable of opening the door for out-of-state financial institutions to operate remote service units in Kansas. To date, it has not seen fit to amend K.S.A. 9-1111 in the Banking Code in the same way as K.S.A. 1982 Supp. 17-5565 of the Savings and Loan Code, and we are not prepared to read into the former statute by implication what the legislature has declined to put there expressly.

Therefore, in our opinion a Kansas bank is without authority to enter into an agreement for the joint operation of remote service units, such as automatic teller machines, with another bank which does not have its principal place of business located in this state.

Very truly yours,

ROBERT T. STEPHAN
Attorney General of Kansas

Jeffrey S. Southard
Assistant Attorney General

RTS:BJS:JSS:hle

Shared Automated Teller Networks: Some of the Aspects

Their Operation Has Many Facets, while the Legal Ramifications Require Much Research

By SUSAN INGRAM
and ANITA L. BOOMSTEIN

Recent advancements in technology have enabled banks to offer new services to their retail customers. Consumers now have the ability to conduct banking transactions at the automated teller machines of their own banks. Additionally, shared ATM networks have been formed by banks to allow their customers to perform financial transactions at the ATMs of other banks.

Over the past 10 years, there has been a rapid increase in the number of ATMs installed by banks. While financial institutions had installed almost 2,000 ATMs throughout the United States in 1973, by the end of 1982 nearly 36,000 ATMs were in place. Projections call for a continued and steady growth in ATM installation through 1990. Shared networks have increased in popularity for two principal reasons — they enable banks to offer ATM services on a more widespread basis, and they assist banks in gaining a competitive advantage in their home markets. In fact, there has been such a proliferation of ATM networks that, by the end of 1982, there were more than 125 shared networks in the United States.

Their Development

There have been several stages in the development of ATM networks. Most networks started out as proprietary vehicles established by one financial institution for the use of its customers only. The majority of these networks were established by large money center banks willing to make the monetary commitment and develop the technical resources required to form and operate such systems. Gradually, banks realized that they could achieve economies of scale and cost reductions, as well as generate additional revenue, by permitting other financial institutions to have access to their networks. At the same time, medium and smaller banks, lacking the financial resources to develop their own networks, wanted the advantages of offering ATM network service to their customers.

Thus a second phase in the development of ATM networks began in which networks were established for the use of more than one bank. Most often, this was accomplished by banks with existing proprietary networks offering their switching services to other banks for ATM interchange. These proprietary networks became multibank networks predominantly controlled by the initiating bank acting as the service provider to the group. To protect each participating institution's customer base and thus insure that the initiating bank's involvement would not be apparent to the public, a separate logo and identity was often established for the network. Some of these networks, such as the MAC system established in 1979 by Philadelphia National Bank and the Instant Teller network formed by City National Bank in Beverly Hills in 1977, continue to be successful today.

Within the past few years, shared ATM networks have entered their third and most sophisticated stage to date. In this stage, multibank networks have been organized through the cooperative efforts of groups of banks. These networks have proliferated largely because of the tremendous advances in technology that have enabled them to structure a complex network and the desire of participating banks to offer ATM services on a wider geographic scale.

The legal and operational aspects of shared automated teller machine networks are discussed by Ms. Ingram and Ms. Boomstein. Ms. Ingram is an attorney in private practice in New York City and is also editor of the EFT Press Alert. Ms. Boomstein is vice president and counsel for Chase Manhattan Bank NA. (Reprinted by permission from the Bankers Magazine September-October 1983. Copyright 1983 Warren, Gorham & Lamont Inc., 210 South St., Boston, Mass. All rights reserved.)

Multibank networks have been formed on intrastate, regional, and national bases. An example of a recently created statewide ATM network is the Florida Interchange Group's Honor System. Among the regional networks that have been formed are Pulse and MPACT, which operate in the Southwest, and the EFT Group, which operates in several mid-Atlantic states. Included among the national ATM networks are Plus, CIRRUS, ADP/The Exchange, Nationet, as well as networks being organized by Mastercard and Visa.

This last stage in the development of shared ATM networks has been highly dynamic. Indeed, while keeping their own identities, many intrastate and regional networks have linked up with other networks to offer their services on a broader geographic scale. Not only have banks established separate networks, but networks have joined forces to encourage more widespread

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use of their ATMs.

Many shared networks being formed today differ from their earlier counterparts in that they involve much more of a joint effort among their member banks. Typically, no individual bank holds a preeminent position, as was the case with earlier networks; rather, a group of banks forms a separate entity specifically to accomplish ATM interchange. As a joint body, the members determine the rules that will govern their relationship.

The Components

Although the configuration of a shared network may vary to some degree, all networks will have certain basic components, such as access devices (ordinarily debit or credit cards), ATM terminals, communications lines, a switching mechanism, and computer hardware and software. Typically, each member bank will connect one or more of its ATMs to the network. In addition, the network itself may deploy ATMs that are owned by the entire group — although, for reasons discussed later, most networks have chosen not to purchase their own ATMs but to utilize those of individual members instead. ATMs may perform such banking functions as cash withdrawals, balance inquiries, transfer of funds, deposits of cash or checks, and bill payment.

"Communications lines," which may be dial-up phone lines and/or dedicated tie-lines, connect the member bank's ATMs to its own master computer and in turn provide the connection with the network's computer. The network's "switching" acts as a highway to route transaction information among the parties. The network may choose to develop its own switch and computer capacity or, because of the time and expense involved, may choose to enter into a separate contract for switching and computer capability with one of its members or with an outside service-provider. The network's computer can maintain the data base containing the information needed to perform transactions directly, or keep a limited data base and route the transaction to the card-issuing bank.

A typical routing process for an interchange transaction is as follows: a customer inserts an access device in a member bank's ATM; depending upon the extent of the data base maintained in the network's computer, either the message is answered at the network's computer or it is routed via the switch to the card-issuing bank; if the card-issuing bank receives the message (because the network's computer does not have the requested information), it reviews its records and provides information to the network's computer concerning the particular transaction (such as whether the transaction should be authorized or what the cardholder's balance is); this information is then relayed by the network's switch back to the ATM bank so that the transaction can be completed.

There are various forms of organization that a network may take. For a network essentially being run by one bank, that bank may choose to operate its network services within the bank's existing structure (for example, as a division of the bank) or the bank may decide to form a separate subsidiary to provide such services.

Most multibank shared networks have chosen to form either a for-profit or not-for-profit corporation. In either case, there are a number of reasons why a corporate structure may be desirable — the principal one is that the liability of the individual members will be limited to the amount of their investment in the corporation.

In determining whether to choose for-profit or not-for-profit status, the group should review its goals for the network. Does it expect the network to make money as a service-provider for other organizations or banks outside of the network? If the group is concerned with providing services only to its members and is simply passing along the costs of running the switch, it will probably choose not-for-profit status. If, on the other hand, the group anticipates having excess switching and computer capacity and foresees operating the switch as a money-making enterprise, it may choose to form a for-profit corporation.

Legal counsel's input, based on an analysis of the group's specific needs, is extremely important at this stage in choosing the correct structure for a network. In addition to helping select the type of corporate structure, counsel must also assist the group in deciding where to incorporate, since incorporation laws differ from state to state. Certain factors — such as the tax treatment afforded the corporation and the requirements of state regulatory agencies — will obviously affect this decision. Indeed, national or larger regional networks with members from many different states may want to shop around for the most favorable state in which to incorporate. Smaller regional networks may find it advisable to incorporate in one of their home states because their activities will primarily be located in that state.

Many shared networks being formed today differ from their earlier counterparts in that they involve much more of a joint effort among their member banks.

Finally, depending upon the types of financial institutions that comprise the network, there may be laws and regulations that permit the network to conduct its ATM-sharing activities through a specifically authorized type of corporation. For example, a network of banks may choose to conduct its activities through a bank service corporation as authorized by the Bank Service Corporation Act.

Bylaws of the Network

Assuming that a corporate structure is chosen as the means of conducting the network, the legal rights and obligations of the members will be contained in the certificate of incorporation and the bylaws. As with most corporations, the certificate and bylaws describe the general structure and procedures under which the corporation will function. More technical details concerning the daily operations are typically placed in a separate set of operating regulations.

A network may wish to consider a corporate structure that permits more

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than one type or class of membership. A number of shared networks have adopted two or three classes of memberships, thus taking into account the needs of members who wish to own and govern the organization (principal members) as well as members who wish to participate in the services of the network with more limited financial and legal obligations (secondary members).

Principal members have all or a majority of the voting rights in a shared network. In the case of a for-profit corporation, principal members also share in the profits and losses of the network. Principal members generally control the day-to-day management and direction of the network concerning issues such as the admission of new members, the types of services that will be provided, the fees that will be charged, and the territories in which each member will operate. Also, a substantial initial investment may be required of the principal members who form a network.

Secondary members can participate in the activities of the shared netw but will have a lesser say in its man ment and direction. Additionally, a network may establish uniform fees and rules for its secondary members or it may allow the sponsoring principal members to make such decisions.

Finally, some networks place restrictions on the types of institutions that may own and participate in the services of the network. There are networks comprised solely of commercial banks, or thrifts and savings and loan associations, while others contain several t of financial institutions. One of most controversial decisions to be ma is whether to limit participation in the network exclusively to depository institutions — thus prohibiting ownership and/or access by nonbanks. Also, the bylaws of a network may place restrictions on the ability of members to join or participate in other competing networks. Since a shared ATM network is a joint venture among a group of banks, antitrust implications must be considered in connection with such exclusive arrangements.

Location of Terminals

The success of a shared network will depend, in part, on the number of members and the number and strategic placement of ATMs within the network's sphere of operations. To insure adequate coverage and generate usage by customers, a broad geographic representation of members is desirable, whether the network is established on a national, regional, or local basis. The bylaws of some networks are specific as to the location of terminals and the number of terminals that each member must make available for use by the network. Other networks allow individual members discretion as to which and how many terminals will be part of the network. As a means of encouraging members to promote the network with a given locale, some networks intentionally create a scheme of territorial exclusivity. Each principal member may be given total discretion as to whether and upon what terms secondary members will be permitted to join the network within that member's territory. Once again, the antitrust implications of such an exclusive arrangement must be considered.

In Busy Areas

Although most ATMs currently are located in bank branches and vestibules, several networks are beginning to place ATMs in high-traffic areas, such as airports, supermarkets, and shopping malls. Indeed, the installation of ATMs that are shared by more than one network may prove to be a cost-effective means of providing terminals in certain locations.

The location and ownership of terminals are subject to restrictions contained in federal and state banking laws. Most multistate shared networks have chosen, because of branching prohibitions contained in federal banking laws, not to purchase their own terminals. Instead, they use ATMs that are owned and operated by members in their respective states. This alternative has been adopted in response to Independent Bankers Association of America vs. Smith and subsequent interpretations issued by the Comptroller of the Currency. In IBAA vs. Smith, the court held that an out-of-state bank would be considered to be engaged in interstate banking if it established (i.e., owned or rented) an ATM in a foreign state. As a result of this holding, the Comptroller has taken the position that a national bank may use an ATM across state lines if, rather than owning or renting the terminal, it pays a transaction fee for use of the ATM.

Types of Activities

The participants in a shared network will have to determine the types of activities in which the network will engage and insure that they are consistent with its certificate of corporation and bylaws. The members must determine whether the network will be limited solely to ATM interchange or whether it will also engage in transactions through point-of-sale terminals and other forms of electronic fund transfer as they evolve. In most cases, it is advisable that the certificate of incorporation and the bylaws be drafted to allow the network to have maximum flexibility in offering new services and engaging in new activities and permit the network to keep abreast of changes in the law, the marketplace, and new technology.

Members must also determine what types of functions are to be performed through the network's ATMs and whether the choice of functions will be set uniformly by the network or left to the discretion of individual ATM owners. Clearly, as a competitive measure, a network will want its ATMs to perform such routine functions as cash withdrawals, money transfer between accounts, and balance inquiries. The most critical decision for a network and its members, however is whether to permit the taking o deposits at an ATM, particularly deposits made by the bank's customer at a terminal located outside the state in which the bank is located. More than any other function at an ATM, the taking of a deposit may raise a serious legal question as to whether an out-of-state bank is engaged in the business

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of banking in the state where the ATM is located. As a result, many networks have sought to avoid implications of interstate banking by prohibiting deposits to be made through the network's ATMs.

Operation of the Switch

In order for the shared network to function, the switch (including the hardware, software, switching mechanism, and communications lines) must be developed, operated, and maintained. This may be done in one of three ways: one of the members can own and operate the switch, the network can perform this function itself, or a third party can operate the facility on behalf of the network. If a member or a third party is to perform this function, the network will need an agreement with that party as the facility manager. Depending upon the needs and desires of the network, the facility manager can serve the limited function of maintaining the computer facility or the manager can serve a more comprehensive role, which may include administering the network, overseeing the admission of new members, marketing the services of the network, settling fees for transactions through the switch, and monitoring performance standards.

Performance Standards

The network's bylaws and/or operating regulations should contain performance standards for its members and for the switch operator. These standards should include the desired or minimally acceptable response time for members and the switch operator, uptime and down-time standards for the switch, and a mechanism to monitor the performance of the switch operator and the members. The network may also wish to establish standards or goals for the number of access cards issued by members and the number of terminals in the network. These standards may be monitored by the switch operator, the network's board of directors, or both. In addition, the penalty to be placed on the switch operator or the members for failure to meet designated standards should be determined in advance and set forth in the bylaws. Such penalties may include increased fees, the imposition of probationary status, loss of a member's exclusive territory, or even expulsion from the network.

Use of Name

The network's name and logo are its most valuable assets. The network should register its name and logo, and should insure that its service marks are protected from infringement by others. In granting its members a license to use its service marks, the network may impose reasonable standards for such use.

The network should undertake to aggressively promote its name. This will typically include allocation of funds to be devoted to advertising, either by the network or the individual members. To assume proper use of the name and logo and to maintain the desired quality standards, the network may require member-generated advertising to receive approval prior to its use or publication.

Fees

In order that fees and orderly settlement and payment among members be uniform, the network may establish a standard schedule of fees for all of its services. Fees may include a joining fee, a transaction fee for using the switch, a transaction fee paid to a member whose terminal is used, and other miscellaneous assessments. Due to antitrust concerns, while the network may set fees for its services, the network should not interfere with the right of its members to impose other fees, such as charges by members to their own customers.

EFT Laws

The field of electronic funds transfer is highly regulated by both federal and state law. In 1978, Congress enacted the Electronic Funds Transfer Act in an effort to define the rights and liabilities of users and providers of ATMs and other electronic services. The federal law is primarily concerned with consumer protection and includes rules governing disclosures, the issuance of access devices, procedures for error resolution, and limitations on the consumer's liability for unauthorized transactions. Additionally, approximately 35 states have enacted laws that in some way govern ATM transactions, many of which contain provisions relating to deployment of terminals as well as consumer protections. There is no uniform treatment of EFT-related issues among those states that have enacted such laws. As a result, a multistate shared network must carefully review the laws of each state in which it intends to operate.

The network's name and logo are its most valuable assets. The network should register its name and logo, and should insure that its service marks are protected from infringement by others.

State laws dealing with ATM deployment are typically concerned with the location and ownership of ATMs by banks within the state. In several states,

such as New York and California, since an ATM is defined as a branch, its operation may be subject to stricter regulatory authority. Some states, such as Illinois, have enacted consumer protection provisions similar to those contained in the federal EFT Act, while others, including Massachusetts, have gone beyond the federal law and afford consumers even greater protection in such areas as privacy and liability for unauthorized use.

A number of state laws also contain provisions regarding the sharing of ATMs within the state. These provisions range from the extreme of mandatory sharing in states such as Connecticut (with respect to off-premises ATMs) and Nebraska, to permissive sharing in states such as New York. A state's sharing law may impact on a financial institution's participation in a network, especially since some states have outright prohibitions against an out-of-state bank's use of ATMs within the state.

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A subject of particular concern to a shared network is error resolution. The federal EFT Act sets forth procedures and time periods for resolving consumer disputes. Certain state laws also contain error resolution procedures, in some cases with stricter requirements than the federal law. Thus the network's bylaws and/or operating regulations must insure that the members exchange information relating to error resolution in compliance with both federal and state laws.

A newly formed network will have to balance the concerns of its individual members and determine in which areas to concentrate its time and resources. To accomplish its goals, a network should also establish clearly defined operational guidelines. While these guidelines must be specific, they should allow sufficient flexibility to enable the network to respond to changes in the law and technology. By addressing these concerns in its formative stage, a network will be establishing a solid foundation for achieving its current and future goals. ■

By Paul Schmeltzer

Vice President and Marketing Director
Financial Card Services Division
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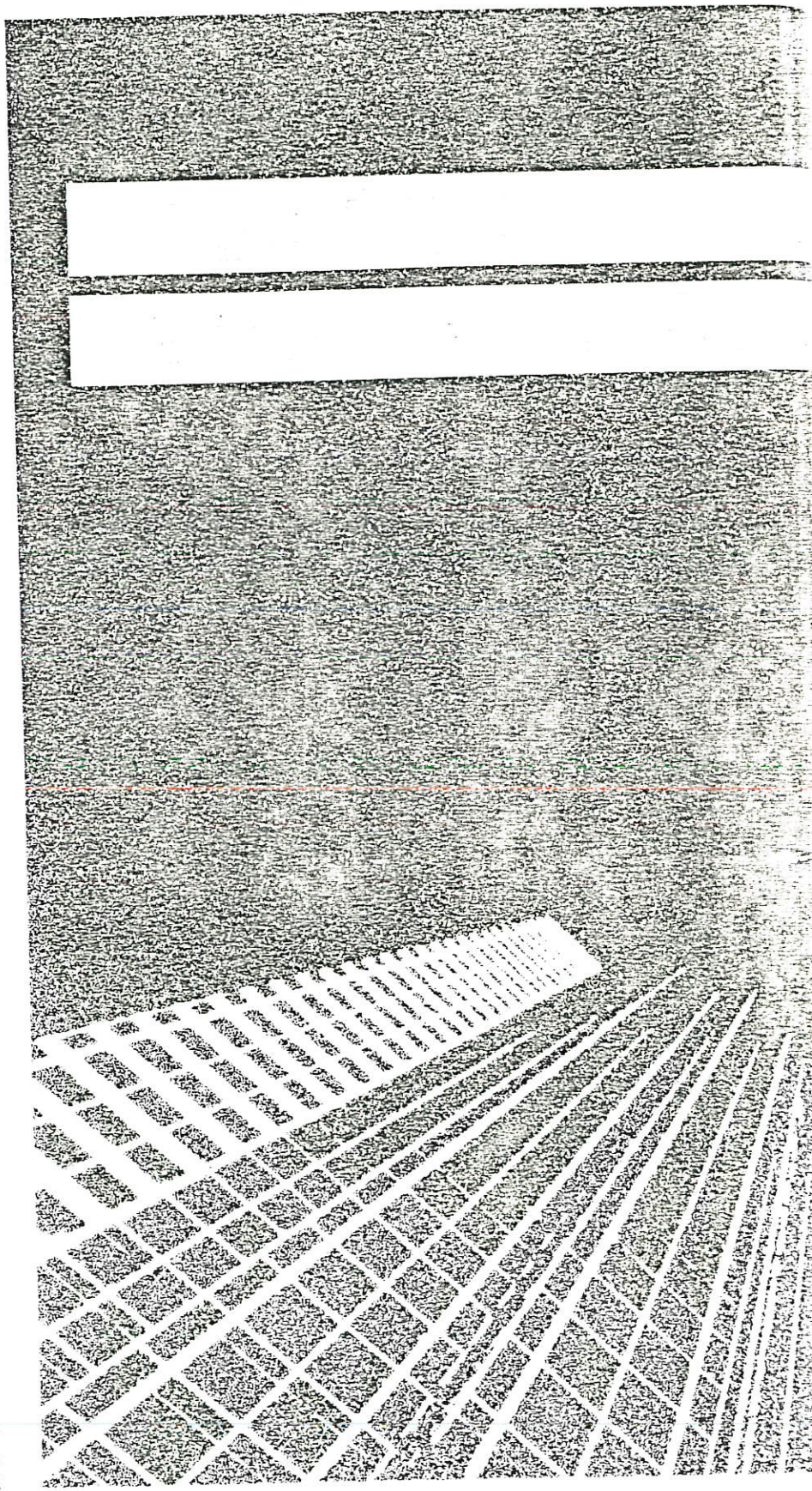
Columbus, Ohio

The ATM networks are certainly at the forefront of change in the financial services industry. But are they doing a good job of leading the industry into the new deregulated world? What role should they assume in this new world?

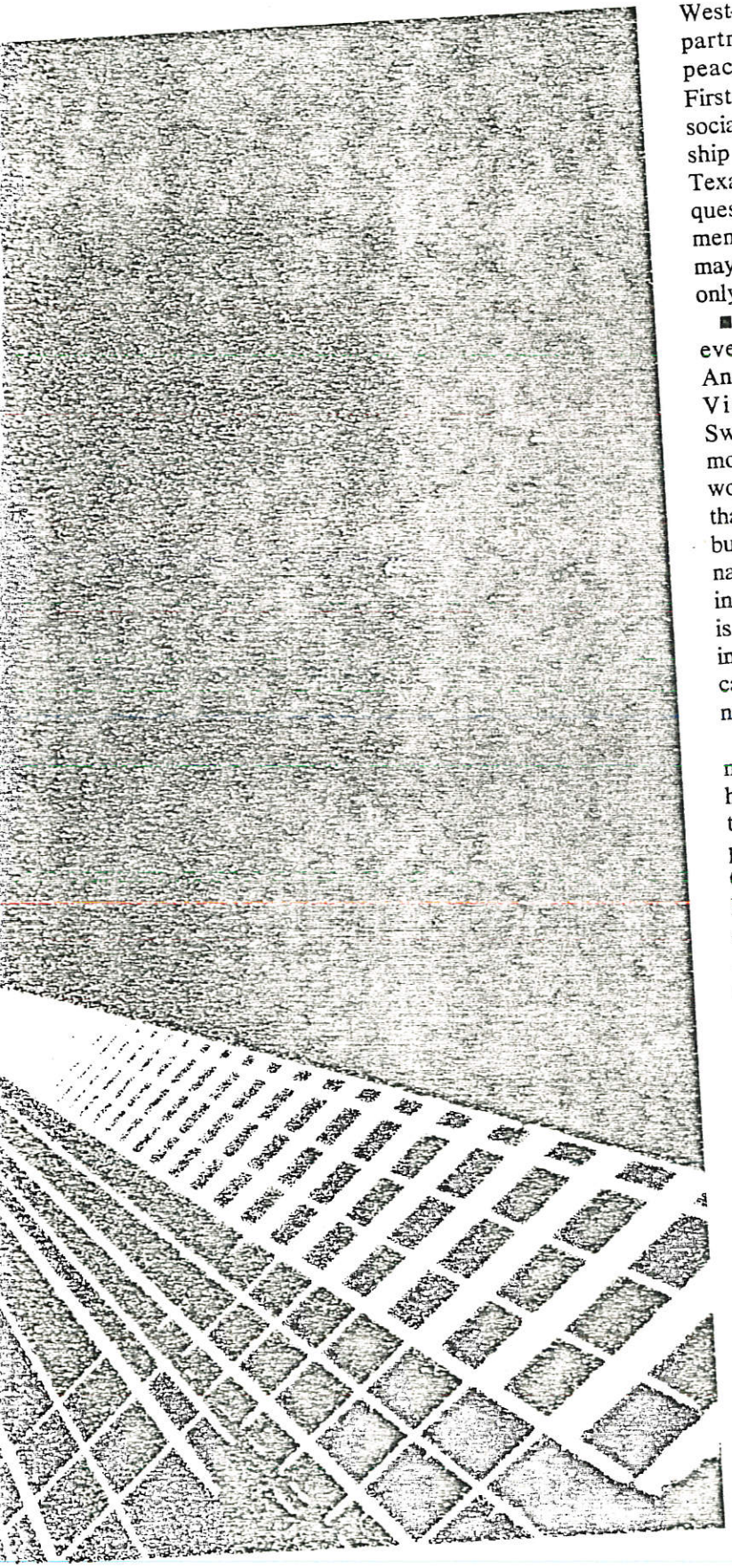


Network Reflections

Year's end is a time for reflection on events just passed and events yet to come. As the financial services industry closes out 1983, reflection on the network chapter just written and the chapters ahead seems appropriate.

The concepts of shared ATMs and EFT interchange gained real acceptance in 1982. There was a rush to pick partners, a rush to stake out territorial claims. In many respects 1983 has been a year of implementation. It has also been a year of significant events—events that are important not only for the networks themselves, but for the world of financial services. Consider these examples:

- In 1983, Plus, Cirrus and recently Nationet came out of the boardroom and into the marketplace. Their accomplishments are the product of a great deal of hard work by some real leaders in the banking industry. Congratulations are certainly in order. But so is moderation if we consider the rest of this year's events and the work that remains in the years ahead.
- Competition continued strong among the regional networks as the successful continued to grow and others paused to reflect. Two years ago I characterized Texas as a "John Wayne shoot-out!" Pulse and MPACT have fought it out in the best traditions of the Old



West—that is until the Justice Department decided to step in as peacemaker. Justice supported First Texas Savings and Loan Association's bid for "dual" membership in MPACT and Pulse. First Texas wasted no time in calling into question any policy of exclusive membership. The eventual result may be plurality—just like duality, only bigger.

■ In another pair of bellwether events, ADP acquired the Easy Answer network in Illinois, and Visa acquired the Maryland Switch. I believe 1984 will see more of this consolidation as networks founded more on emotion than the economics of a rigorous business case acknowledge the financial consequences of continued independent operation. Visa's step is doubly significant as a milestone in its process of transition from a card business to a network business.

■ POS will be a network business. California's big five banks have acknowledged that fact in their recently announced POS project. While Bank of America, Crocker, First Interstate, Security Pacific and Wells Fargo all have strong proprietary stakes in their ATM networks, POS will be a different ball game.

■ The third-party players have also been busy in 1983. J.C. Penney made major moves in the network market, signing Shell and Gulf for POS services and acquiring First Bank System's home banking technology. And, most recently, Exxon announced plans to issue its own debit card.

Not to be outdone, Sears is expanding its network of financial centers and plans to have 250 nationwide by year-end 1984 and over 600 by 1986. In addition, Mr. Telling is rolling out his shopping cart nationwide with banks and S&L's on his list. One wonders what networks he may buy into in the process.

The new entrants are big and visible, but more impressive may be the subtle, structural variety of the market. Consider Citicorp's interface to Safeway's ATM network; Honor's move to surround Publix; and Matrix, the Manufacturer's Hanover/NCR joint venture. Remarkable bedfellows indeed!

New World Reflections

It is now clear that the financial services market is a much broader market today than that served by traditional financial institutions only a few years ago. Insurance companies own brokers. Brokers own banks. Banks broker securities and insurance. All across the country financial institutions and financial service corporations are going around wearing each other's clothes.

We are, in fact, witnessing fundamental, structural change in the payment system and the financial services industry. A new world of financial services is emerging today, a world crafted by colliding forces of change. Deep-seated forces that are, perhaps for the first time, largely beyond our control. These forces include shifting markets, changing competitive roles and the accelerated revolution in technology.

The mass markets of an industrial age are giving way to markets segmented by the communications and technology of an information age. Insights offered by works such as Alvin Toeffler's *Third Wave* and John Naisbitts' *Megatrends* are fundamental to an understanding of customers' changing values and the market niches which financial services providers will occupy.

Competitive roles are changing as the medium of financial exchange shifts from documents to electronic image and impulse. That shift is removing the traditional entry barriers to nonbank operation of the payment system. In short, anyone with a computer, including your customer and mine, is more able to participate. Banking's exclusive franchise on the payment system is crumbling. It is indeed a new world. A world of financial automation.

The essential financial service will survive, of course. The essential financial service is the secure store and convenient exchange of value. In the new world, that value is information—information that represents the deposits we will compete for. And we will compete with a myriad of services and competitive options, services that go beyond checking and savings, services beyond ATMs and POS—services such as financial planning, central asset accounts, equity based credit, private-sector ACH, check truncation, cash management services, investment services and home information.

Technology is in fact changing our concepts of product development and service delivery. Did the consumer demand ATM services? No. We invented technology and created a market with it. As Dr. Alan Lipis, founder of Electronic Banking, Inc., said in a recent speech, quoting Marshall McLuhan, "The medium is the message."

The new world of financial services is a world "belonging to the medium of technology." Divide that world into two hemispheres, data base and data delivery. Data base is the repository for financial information, our electronic deposits. Data delivery is the communications hemisphere. It is terminal and network based access to the data base.

Today, ATM networks are the embryonic foundation for our data delivery systems. Data delivery

systems are a key component of banking's ability to compete in a world where new markets, new products, new competition and new technology are the order of the day.

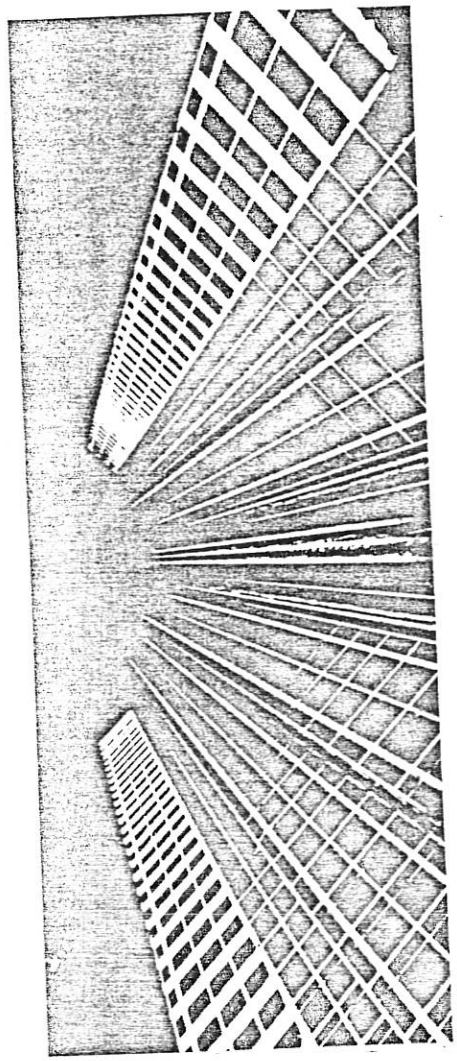
Leadership Reflections

The ATM networks are providing significant influences on the shape of the industry's new order. Much has already been accomplished, yet a great deal remains to be done. Most accomplishment to date has focused on the technical and operational requirements for establishing electronic payment systems.

Technical communications standards such as the American National Standards Institute's X9.2 Standard are gradually gaining acceptance in all the major networks. The networks have begun to address requirements for network security. National Automated Clearing House Association formats are becoming *de facto* standards for batch oriented data transfer. The networks are clearly earning high marks for their technical leadership.

The process of technical leadership must continue. Significant problems still remain. Communications cost is becoming a major problem across the industry. The break-up of AT&T has launched a transition from regulated monopoly to unregulated monopoly. Communications services will remain monopolistic in price and quality until viable competitive alternatives exist. Opportunities for technical leadership will remain for some time.

The network role in shaping the new world can and should be broader than just technology. There are a number of additional areas where industry leadership could be provided by the networks. These include regulatory issues, product direction and financial performance.



Network growth and banking's ability to compete in the new world are constrained by the absence of a coherent national policy for interstate deployment of EFT services. Today this condition works to the advantage of everyone except bankers. If, as an industry, banking continues to pick its way through the current maze while simultaneously attempting to protect our turf, it will only forfeit an even larger share of its payment system franchise to unregulated competitors. To date the networks have been a little-heard voice on these issues.

Product direction is critical to a network oriented evaluation of the payment system. Beyond ATMs, a myriad of network services are possible in the years ahead. The number that actually become reality, however, will be determined largely by the winners in the next round of competition.

ATM interchange is only a positioning stage for the electronic transformation of the payment system at the point of sale. For some of us it has been a long time coming, but the time has come. The card base is there. The merchant is ready. The network foundations are being laid in place, but the issue of banking's leadership role in the emerging payment system remains in doubt. Third-party networks and retailer issued debit cards are a reality that cannot be ignored. Aggressive leadership is needed.

Finally network profitability is an area of concern. If the networks are to be viable businesses in the long run, they must become profitable. Today I suspect most networks, particularly the smaller ones, are not profitable. Merger or acquisition may provide the answer for some, but for most, aggressive management and realistic pricing are an imperative.

Toward A New World

The new world is a product of deep-seated forces of change. It implies a new culture, a culture more in touch with its markets than ever before. It will be a world that rewards the right product, in the right place, at the right time. The ATM networks are in the right place at the right time. It is time to press that advantage. It is time to lead.

Clearly these are turbulent times in the financial service industries. Change is always turbulent. But we are, in a very real sense, giving birth to a change of great dimension, a new culture. Would-be survivors in the new order, including the ATM networks, must recognize that change and adapt. ■

KLSI Kansas League of Savings Institutions

JAMES R. TURNER, President • Suite 612 • 700 Kansas Ave. • Topeka, KS 66603 • 913/232-8215

January 31, 1984

TO: SENATE COMMERCIAL AND FINANCIAL INSTITUTIONS COMMITTEE

FROM: JIM TURNER, KANSAS LEAGUE OF SAVINGS INSTITUTIONS

RE: S.B. 590, REMOTE SERVICE UNITS

The Kansas League of Savings Institutions appreciates the opportunity to appear before the committee in support of S.B. 590 which would expand the availability and utilization of remote service units by savings and loan associations. The proposal is a companion bill to S.B. 523, introduced by the Kansas Bankers Association, which we also support.

Further, we would ask that the committee amend S.B. 590 by deleting all of line 20 beginning with the word "subject" through line 22 ending with the word "regulations." And that the word "Any" be capitalized to begin the sentence on line 22 and that after the word "association" the following be added: "or savings bank having its principal office in this state." These amendments would bring the language of S.B. 590 into conformity with S.B. 523.

We would ask the committee's consideration of reporting S.B. 590 and S.B. 523 favorably for passage.

James R. Turner
President

JRT:bw

Attachment II